Supreme Court, U.S.
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No. 04-

IN THE

Supreme Court of the United States

VERANDA BEACH, LLC,

Petitioner,

v.

RLI INSURANCE CO.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The owner of a construction project sued the surety in federal court under a standard-form performance bond published by the American Institute of Architects ("AIA"), widely used in the construction industry, and containing a judicial dispute resolution provision:

> 9. Any proceeding, legal or equitable, under this Bond may be instituted in any *court* of competent jurisdiction in the location in which the work or part of the work is located. . . .

The lower courts compelled arbitration of the bond claims under § 2 of the Federal Arbitration Act, using the doctrines of equitable estoppel and incorporation by reference to override the judicial dispute resolution provision, based on an arbitration provision in the underlying AIA standard-form construction contract between the owner and the contractor.

QUESTIONS

1. Whether § 2 of the Federal Arbitration Act prohibits the federal courts from overriding a judicial dispute resolution provision in a standard-form contract in order to compel arbitration under doctrines like equitable estoppel and incorporation by reference?

2. Whether the Court should resolve the conflict between the Fifth Circuit and the Eighth Circuit over the application of § 2 of the Federal Arbitration Act to conflicting judicial dispute resolution and arbitration provisions in standard-form documents?

PARTIES

Petitioner Veranda Beach, LLC ("Veranda") is a Mississippi limited liability company that owned and developed the Magnolia Shores Condominium in Biloxi, Mississippi.

Respondent RLI Insurance Co. ("RLI") is an Illinois insurance company that sold the AIA performance bond to guarantee to Veranda the performance of the AIA construction contract.

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Petitioner Veranda Beach, LLC respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeal for the Fifth Circuit entered in this matter on December 9, 2004.

OPINIONS BELOW

The opinion of the Fifth Circuit that affirmed the district court is reprinted herein as Appendix 1. The district court's order granting the motion to compel arbitration under the doctrines of equitable estoppel and incorporation by reference is reprinted herein as Appendix 2.

STATEMENT OF JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The judgment of the Fifth Circuit was entered December 9, 2004.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. CONST., AMEND. V

> No person shall be . . . deprived of . . . property, without due process of law. . . .

U.S. CONST., AMEND. VII

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved. . . .

§ 2, Federal Arbitration Act, 9 U.S.C. § 2

> A written provision in any ... contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

STATEMENT OF THE CASE

This case raises the question of how far federal courts should go to compel arbitration under § 2 of the Federal Arbitration Act. Apparently in furtherance of a policy to send construction cases to arbitration, the lower courts interpreted the dispute resolution provisions in two AIA construction documents in such a way as to compel arbitration between parties whose standard-form contract contained a provision for judicial resolution of disputes.

The agreement between Petitioner Veranda Beach, LLC and Respondent RLI Insurance Co. is the AIA Performance Bond (AIA Document A312), sold by RLI with Veranda as the obligee. The AIA312 Performance Bond contains the following judicial dispute resolution provision:

> 9. Any proceeding, legal or equitable, under this Bond may be instituted in any **court** of competent jurisdiction in the location in which the work or

> part of the work is located and shall be instituted within two years after the Contractor Default or within two years after the Contractor ceased working or within two years after the Surety refuses or fails to perform its obligations under this Bond, whichever occurs first. . . .

(Emphasis added.)

The Performance Bond guarantees performance of the Construction Contract, which is also an AIA standard-form contract (AIA Document A101-1997and AIA Document A201-1997). It contains an arbitration provision for claims between the owner (Veranda) and the contractor (United Contractors), a prohibition against construing the contract to create contractual relationships between parties other than the owner and the contractor, and a limitation on arbitration:

> 1.12 The Contract. . . . The Contract Documents shall not be construed to create a contractual relationship of any kind. . . (3) between any persons or entities other than the Owner and Contractor.
>
> 4.6 Arbitration
>
> . . .
>
> 4.6.2 Claims not resolved by mediation shall be decided by arbitration . . . in accordance withe the Rules of the American Arbitration Association currently in effect. . . .

> 4.6.4 Limitation on Consolidation or Joinder. No arbitration arising out of or relating to the Contract shall include, by consolidation or joinder or in any other manner ... parties other than the Owner, Contractor, a separate contractor as described in Article 6 and other persons substantially involved in a common question of fact or law whose presence is required if complete relief is to be accorded in arbitration.

The two AIA construction documents set up the following regime for dispute resolution:

Contract	Parties	Forum
Construction Contract	Owner/Contractor Joinder Parties	Arbitration
Performance Bond	Owner/Surety	Court

Veranda sued RLI in the Southern District of Mississippi under diversity jurisdiction, seeking damages and other relief under the Performance Bond for construction delays, defects, and deficiencies arising out of the construction of a condominium project in Biloxi, Mississippi. There was no arbitration between the contractor and Veranda to activate the joinder provision in the construction contract. RLI moved to compel arbitration, claiming that a certain *Memorandum of Understanding* contained an arbitration agreement. The district court recognized problems in the formation and interpretation of the alleged arbitration provision in the *Memorandum of Understanding* and implicitly rejected it as a basis for arbitration. The district court acknowledged that the Performance Bond did not contain an arbitration

agreement but instead contained a judicial dispute resolution provision:

> The performance bond does not contain an arbitration provision, but does provide that any lawsuit against RLI be brought in a court of competent jurisdiction where the work is located.

(App. 2, pp.1-2) The district court applied two theories *sua sponte* to compel arbitration: (1) equitable estoppel required Veranda to arbitrate claims against RLI pursuant to the arbitration provision in the Construction Contract; and (2) the Performance Bond incorporated by reference the arbitration provision in the Construction Contract:

> A non-signatory to a contract containing an arbitration provision may compel arbitration against the signatory of that contract only if one of these conditions is met: (1) the signatory "raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract"; or (2) the signatory "must rely on the terms of the written agreement in asserting claims against the non-signatory." *Grigson v. Creative Artists Agency, L.L.C.*, 210 F.3d 524, 527 (5th Cir. 2000), *reh'g en banc denied* 218 F.3d 745 & *cert. denied*, 531 U.S. 1013. The Court finds that the dispute regarding liability for the alleged default in the construction contract is precisely why the performance bond was procured. Accordingly, the Court further finds that RLI can move to enforce the arbitration clause even though RLI did not sign the construction contract.

> Furthermore, when a performance bond incorporates the provisions of a contract, the arbitration provisions of the contract are made part of the bond and are applicable to disputes involving the surety. *J.S.&H. Constr. Co. v. Richmond County Hosp. Auth.*, 473 F.2d 212, 216 (5th Cir. 1973). Although neither party provides reference to this well-settled rule, the Court has found that the performance bond specifically incorporates the construction contract as shown by the following:
>
> > The Contractor and the Surety, jointly and severally, bind themselves, their heirs, executors, administrators, successors and assigns to the Owner for performance of the Construction Contract, which is incorporated herein by reference.
>
> This provision renders Veranda Beach's claims subject to the arbitration clause. . . .

(App. 2, pp. 5-6)

The district court gave no effect to the judicial dispute resolution provision in the Performance Bond and offered no explanation why equitable estoppel and incorporation by reference overrode the judicial dispute resolution provision or why the arbitration provision in the Construction Contract was construed to create an arbitration agreement between Veranda and RLI.

In accordance with the order to compel arbitration, Veranda filed an arbitration proceeding. After the arbitration, RLI moved to confirm the arbitration award and Veranda moved to vacate the arbitration award. The district court affirmed the arbitration award. Veranda appealed the order to compel arbitration and the arbitration award.

After oral argument, the Fifth Circuit affirmed without opinion. (App. 1)

REASONS FOR GRANTING THE PETITION

1. *Arbitration Guidelines for Lower Courts*

This case presents an opportunity to establish rules and guidelines for compelling arbitration – an important need because of the growing number of motions to compel arbitration in commercial and consumer disputes and the expanding trend to employ various doctrines to compel arbitration between parties that have not agreed to arbitrate the claims in the case.

(a) Absence of Agreement to Arbitrate

In the case *sub judice*, the lower courts crossed the line in pursuit of a proarbitration policy to send construction disputes to arbitration. Here, the parties agreed to resolve disputes in court, yet the lower courts employed the doctrines of equitable estoppel and incorporation by reference to compel arbitration – without explanation, justification, or authority to override the agreement between the parties to resolve disputes in court.

Section 2 of the FAA provides that "a written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Court has consistently stated that there must be a written agreement to arbitrate between the parties. In *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002), the Court cautioned against compelling arbitration in pursuit of a proarbitration policy contrary to the plain text of the contract between the parties:

> The FAA directs courts to place arbitration agreements on equal footing with other contracts, but it "does not require parties to arbitrate when they have not agreed to do so." Because the FAA is "at bottom a policy guaranteeing the enforcement of private contractual arrangements," we look first to whether the parties agreed to arbitrate a dispute, not to general policy goals, to determine the scope of the agreement. While ambiguities in the language of the agreement should be resolved in favor of arbitration, we do not override the clear intent of the parties, or reach a result inconsistent with the plain text of the contract, simply because the policy favoring arbitration is implicated. "Arbitration under the [FAA] is a matter of consent, not coercion." Here there is no ambiguity. No one asserts that the EEOC is a party to the contract, or that it agreed to arbitrate its claims. It goes without saying that a contract cannot bind a nonparty. Accordingly, the proarbitration policy goals of the FAA do not require the agency to

> relinquish its statutory authority if it has not agreed to do so.

Id. at 293-94 (citations omitted). *See also Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002) ("arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit") (*quoting Steelworkers v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582 (1960)); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) ("FAA's proarbitration policy does not operate without regard to the wishes of the contracting parties"); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) ("a party who has not agreed to arbitrate will normally have a right to a court's decision about the merits of its dispute"); *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478-89 (1989) ("FAA does not require parties to arbitrate when they have not agreed to do so. . . . It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms. . . . Arbitration under the Act is a matter of consent, not coercion. . . ."); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985) (FAA's centerpiece provision is written agreement to arbitrate); *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n. 12 (1967) ("[T]he purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so.").

The order to compel arbitration violated the Court's rules that the agreement of the parties must be honored, that § 2 of the FAA requires an agreement to arbitrate between the parties, and that a proarbitration policy cannot be applied to compel arbitration where the parties have not agreed to

arbitration. The lower courts simply overrode the express agreement between Veranda and RLI to resolve disputes in court and in the process eliminated the judicial dispute resolution provision from the Performance Bond and re-wrote the regime for dispute resolution set up in the two AIA documents.

(b) Overzealous Proarbitration Policy

The lower courts offered no reason, explanation, justification, or authority to override the judicial dispute resolution provision in the AIA312 Performance Bond. The only plausible explanation is that the lower courts were pursuing a proarbitration policy to refer construction cases and other commercial disputes to arbitration whenever possible. This is the wrong policy. The Court should enforce and confirm the rule that the proarbitration policy applies only when the parties have agreed to arbitrate – not to whether the parties have agreed to arbitrate.

(c) Re-Writing the AIA Documents and Dispute Resolution Regime

Most important, the holding potentially replaces the judicial dispute resolution provision in all A312 performance bonds with compulsory arbitration. There is no difference between the AIA312 Performance Bond and the AIA101-1997/AIA201-1997 Construction Contract in this case and the AIA312 performance bonds and AIA101-1997/AIA201-1997 construction contracts in every other case, so that the arbitration ruling in this case is applicable to all cases in which the AIA documents are used. For that matter, compulsory arbitration through equitable estoppel applies in every case, according to the ruling in this case, in which the

AIA312 performance bond guarantees performance of a construction contract with an arbitration provision. Thus, whenever the construction contract contains an arbitration provision for disputes between the owner and the contractor, equitable estoppel and/or incorporation by reference eliminate the judicial dispute resolution provision or other dispute resolution provision in the performance bond. The lower courts re-wrote the dispute resolution regime set up in the AIA documents by making claims under the AIA312 Performance Bond subject to arbitration and by eliminating the restrictions in the AIA101-1997 Construction Contract on creating contractual relationships between other parties and on the parties with the right to arbitration.

Because the arbitration ruling implicates standardized construction documents used nationwide, this Court should take this opportunity to instruct the lower courts to refrain from pursuing a proarbitration policy contrary to the provisions of the standard-form documents. Otherwise, the courts will be overriding the wishes of the parties and upsetting the industry's dispute resolution regimes.

(d) Policy Considerations

Equally important, as a matter of policy, why should RLI and other issuers and sellers of AIA312 performance bonds and other standard-form contracts with judicial dispute resolution provisions be allowed to compel arbitration of claims under their own standard-form contracts whenever they prefer arbitration to litigation – whether by employing the doctrine of equitable estoppel, incorporation by reference, or any other doctrine or theory? The arbitration ruling in this case signals to the issuers of standard-form contracts that they can seek compulsory arbitration even if their standard-

form contracts do not contain arbitration clauses and even if the standard-form contracts contain judicial dispute resolution provisions. The arbitration ruling opens the door for issuers and sellers of standard-form contracts to compel arbitration without providing for or even disclosing that the buyers and beneficiaries of the standard-form contracts are agreeing to arbitration and surrendering their rights to judicial resolution of claims and their rights to jury trials. It is dubious enough to allow issuers and sellers of standard-form contracts to compel arbitration where their standard-form contracts are silent as to resolution of disputes, providing neither for arbitration nor litigation; it is far more indefensible to allow the issuers and sellers to compel arbitration where their standard-form contracts provide expressly for judicial resolution of disputes.

(e) Constitutional Issue

Constitutionally, the arbitration ruling in this case is fundamentally unfair because it deprives Veranda of its Fifth Amendment right to due process of law in a court of law and its Seventh Amendment right to a jury trial – without notice that it is giving up these rights. In fact, the AIA312 Performance Bond informed Veranda that it had the right to institute "[a]ny proceeding, legal or equitable, under this Bond ... in a court of competent jurisdiction" where the construction project is located. In the face of the judicial dispute resolution provision, no reasonable or rational buyer or obligee of the AIA312 performance bond could possibly realize that he or she was giving up his or her constitutional right to seek redress in court before a jury and was instead agreeing to compulsory arbitration. Veranda relied on the judicial dispute resolution provision and should not lose its

constitutional rights under the doctrine of equitable estoppel, incorporation by reference, or any other undisclosed doctrine or theory.

(f) State-Law Contract Principles

Finally, the Court should take this opportunity to instruct the lower courts to adhere to state-law principles of contract interpretation in resolving motions to compel arbitration – and not ignore or misapply state law in pursuit of proarbitration policies. The Court has established the rule that under § 2 of the FAA, state law governs the interpretation of contracts. *See First Options*, 514 U.S. at 942 ("When deciding whether the parties agreed to arbitrate a certain matter ... courts generally ... should apply ordinary state-law principles that govern the formation of contracts.").

Here, the lower courts ignored Mississippi contract law and in the process contravened several of Mississippi's fundamental rules for contract interpretation. For example, Mississippi contract law requires courts: (1) to enforce contracts as written (i.e., enforce the judicial dispute resolution provision); (2) to give meaning and effect to all contract terms (i.e., give meaning and effect to the judicial dispute resolution provision); (3) to interpret ambiguous terms against the drafter (i.e., against RLI and arbitration); (4) to construe commercial surety bonds strictly against the surety (i.e., strictly against RLI and arbitration); (5) to prefer a special term over a general term (i.e., prefer the special judicial dispute resolution provision over the general incorporation by reference term); and (6) to prefer terms in the performance bond over terms incorporated by reference from the construction contract (i.e., an *Erie*-guess that Mississippi would adopt the rule that the judicial dispute

resolution provision in the performance bond controls over the arbitration provision in the incorporated construction contract).

Similarly, the lower courts ignored the basic rules and policies for equitable estoppel. For example, equitable estoppel has never been used to override an express judicial dispute resolution provision to compel arbitration. Traditionally, equitable estoppel is used to find a contract where none exists, to fill in a contractual gap, so to speak, not to eliminate an existing contractual provision. In the case relied on for equitable estoppel, *Grigson v. Creative Artists Agency, L.L.C.*, 210 F.3d 524, 527 (5th Cir. 2000), there was no contract between the parties, let alone a standard-form contract sold by the party seeking to compel arbitration and containing a judicial dispute resolution provision, and the party resisting arbitration had engaged in forum shopping to avoid arbitration. As a matter of policy, RLI should be the party estopped from seeking to compel arbitration, because it is the party that drafted and sold the AIA312 Performance Bond with the judicial dispute resolution provision and with full knowledge that the AIA101-1997 Construction Contract contained an arbitration provision limited to claims between the owner and the contractor. If RLI wanted to arbitrate claims with the obligee, RLI should not have inserted a judicial dispute resolution provision in the performance bond. The lower courts made no analysis and offered no explanation why equitable estoppel should be used to override a judicial dispute resolution provision in a standard-form contract whenever the drafter and seller of the contract prefers arbitration to litigation. (For a scholarly critique of the use of the doctrine of equitable estoppel to compel arbitration, see the dissent in *Grigson.*)

This case presents an opportunity to notify the lower courts that state-law contract principles must be applied faithfully under § 2 of the FAA.

2. *Conflict between Fifth Circuit and Eighth Circuit*

In *AgGrow Oils v. National Union Fire Ins. Co.*, 242 F.3d 777 (8th Cir. 2001), the Eighth Circuit reached the exact opposite result as the Fifth Circuit. The *AgGrow Oils* performance bond contained the exact same judicial dispute resolution provision as in the AIA312 performance bond:

> [a]ny proceeding, legal or equitable, under this Bond may be instituted in any court of competent jurisdiction in the location in which the work or part of the work is located . . . within two years after the Surety refuses or fails to perform its obligations under this Bond.

Id. at 780. The *AgGrow Oils* performance bond also contained the exact same provision for incorporation for reference as the AIA312 performance bond, and the *AgGrow Oils* construction contract the exact same arbitration provision as the AIA101-1997 construction contract. The Eighth Circuit affirmed the district court's denial of the surety's motion to compel arbitration, finding that the performance bond did not incorporate the arbitration provision because: (1) an intent to arbitrate was not clearly expressed; and (2) any intent to arbitrate was negated: (i) by the bond provision referring to the judicial resolution of disputes; and (ii) by the provision in the construction contract that it "not be construed to create a contractual relationship of any kind . . . between any persons or entities other than the owner and the contractor." *Id.* at 781.

The Eighth circuit concluded:

> Mindful of the fundamental principle that "[a]rbitration under the [Federal Arbitration] Act is a matter of consent, not coercion," *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995), we are unwilling to construe an incorporation clause whose obvious purpose was to clarify the extent of the surety's secondary obligation as also reflecting a mutual intent to compel arbitration of all disputes between the surety and the obligee under the bond.

Id. at 782. Thus, interpreting identical contractual provisions, the Eighth Circuit held that the judicial dispute resolution provision in the performance bond precluded a motion to compel arbitration under the Federal Arbitration Act.

The *AgGrow Oils* district court relied on two additional grounds to reject the theory of incorporation by reference: (1) "In a suit on the performance bond, to the extent that the provisions of the bond and the construction contract conflict, the provisions specifically set forth in the bond control"; and (2) "the bond literally incorporates only [the owner's] promise to arbitrate with [the contractor]; it does not enlarge [the owner's] obligation to encompass mandatory arbitration with [the surety]." *AgGrow Oils v. National Union Fire Ins. Co.*, Case No. A3-99-26. (D.C.N.D. 1999).

The Court should resolve this conflict in the circuits in order to remove the uncertainty in the construction industry over the conflict between the judicial dispute resolution provisions and the arbitration provisions in the AIA standard-form construction documents.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX 1 — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT DATED AND FILED DECEMBER 9, 2004

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 04-60450

VERANDA BEACH, LLC,

Plaintiff-Appellant,

versus

RLI INSURANCE COMPANY,

Defendant-Appellee.

Appeal from the United States District Court
for the Southern District of Mississippi
(1:02-CV-110-Ro)

Before GARZA, STEWART and CLEMENT, Circuit Judges.

PER CURIAM:*

AFFIRMED. See 5TH CIR. R. 47.6

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* Pursuant to 5TH CIR.R.47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR.R.47.5.4.

APPENDIX 2 — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF MISSISSIPPI, SOUTHERN DIVISION DATED AND FILED NOVEMBER 5, 2002

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF MISSISSIPPI SOUTHERN DIVISION

CIVIL ACTION NO. 1:02cv110GR

VERANDA BEACH, L.L.C.

PLAINTIFF

VS.

RLI INSURANCE COMPANY

DEFENDANT

ORDER

This action is before the Court on motion of the defendant, RLI Insurance Company [RLI] to stay further proceedings [5-1] and to compel the plaintiff, Veranda Beach L.L.C. [Veranda Beach] to submit to arbitration [5-2] to resolve a dispute between the parties pursuant to the Federal Arbitration Act, 9 U.S.C. §§ 3-4. After due consideration of the evidence of record, the briefs of counsel, the applicable law, and being otherwise fully advised in the premises, the Court finds as follows.

Appendix 2

Veranda Beach is the owner and developer of the Magnolia Shores condominium project located in Biloxi, Mississippi. Veranda Beach contracted with a general contractor, United Contractors, Inc. [United Contractors], for construction of the condominium units. The contract is a standard American Institute of Architects [AIA] contract and contains arbitration provisions for disputes arising between Veranda Beach and United Contractors. (Pl.'s Resp., Exhs. C-D.) The contract refers to a performance bond to cover faithful performances of the construction contract. (*Id.*, Exh. D, ¶ 11.5.) RLI sold and issued a performance bond binding the contractor, Colonial Builders, L.L.C. and the surety, RLI, to Veranda Beach for performance of the contract. (*Id.*, Exh. E.) The performance bond does not contain an arbitration provision, but does provide that any lawsuit brought against RLI be brought in a court of competent jurisdiction where the work is located which would be Biloxi, Mississippi. (*Id.*, ¶ 9.) Section six of the performance bond obligates RLI for correction of defective work and completion of the construction contract by the contractor; legal, design, professional and delay costs resulting from contractor's default and RLI's actions or failure to act; and actual or liquidated damages, whichever may be applicable. (*Id.*, ¶ 6.)

In March 2001, Veranda Beach put United Contractors on notice that it had defaulted on the construction contract because of construction delays, defects and deficiencies, and other alleged violations of the contract. (*Id.*, Exh. A, ¶ 4.) Under the performance bond, RLI was notified of the default. (*Id.*) A meeting was held on April 30, 2001, to arrange for completion of the project. (*Id.*) Representatives from Veranda Beach, United Contractors, and RLI were present at the

meeting. (*Id.*) Robert Gentle of RLI agreed to take over payment, supervision and completion of the project at that meeting. (*Id.*) In accordance with the terms of the performance bond, Veranda Beach notified United Contractors and RLI that the construction contract was terminated effective May 16, 2001. (*Id.*)

RLI and Veranda Beach executed a memorandum of understanding on May 25, 2001, which provided in part as follows:

> Work will be completed in accordance with the plans and specifications of the architect and the Surety [RLI] acting through its consultant Robert C. Gentle, will oversee and be responsible for scheduling completion of the project.
>
> * * *
>
> Upon full completion of the project, the parties will discuss and negotiate any claims between the parties including, but not limited to, liquidated damages, change orders, time extensions, claims by sub-contractors for extra work, etc. The purpose for this function is to provide dialogue between the parties to settle all outstanding issues in this project. This function will be handled with and through the surety's consultant, Robert C. Gentle and the architect, Gerald J. Hopkins. All unreconciled disputes between the owner, the contractor, and the surety will be resolved as provided by the contract.

(*Id.*, Exh. F.)

Appendix 2

According to the plaintiff, the memorandum of understanding was altered by United Contractors through the addition of a handwritten note on the bottom of page 2 of the document. (*Id.*, Exh. A, p. 4.) The plaintiff maintains that this was not agreed language and was objected to at the time of the alteration. (*Id.*, and Exh. G.)

Construction was not completed on the condominium project and RLI eventually ceased hiring, supervising or paying contractors, subcontractors, suppliers or workers on the project.(*Id.*, Exh. A, p. 5.) When the project was abandoned, completion of the project was more than a year late and Veranda Beach contends there were over 50 defects and deficiencies in the workmanship on the project. (*Id.*) Veranda Beach filed suit against RLI for violations of the performance bond. (Compl.)

RLI claims that a portion of the memorandum of understanding provides that there was an agreement to arbitrate all claims by Veranda Beach against RLI. The provision provides as follows: "All unreconciled disputes between the owner, the contractor and the surety will be resolved as provided in the contract." (Ct. R., Doc. 1, Exh. B, p. 2.) Veranda Beach contends that there was no agreement to arbitrate between Veranda Beach and RLI. The plaintiff contends the memorandum of understanding is not binding on the parties because United Contractors did not sign the original document, but instead proposed a new memorandum of understanding when it added the handwritten provision to its copy of the document and signed it. (Pl.'s Resp., pp. 10-11.) The addition indicated that United Contractor's agreement to the memorandum of understanding

was conditioned on payment until the project is completed. (Mot. to Compel, Exh. 1, p. 2.) Veranda Beach maintains that because it never signed this document there was never a binding memorandum of understanding. (Pl.'s Resp., p. 11.) In addition, the plaintiff argues that RLI was not a party to the construction contract and the contract specifically provides that it does not establish a contractual relationship between any parties other than Veranda Beach and United Contractors. (*Id.*, p. 2.)

Discussion

Section 2 of the Federal Arbitration Act [FAA] provides that "[a] written provision in .. . a contract ... to settle by arbitration a controversy thereafter arising out of such contract ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The arbitration process is strongly favored in federal courts. *See Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25 (1991). The Court will not, however, compel a party to arbitrate a dispute unless the party has agreed to arbitration. *See United Steelworkers* of *Am. v. Warrior & Gulf Navigation Co.*, 363 U. S. 574, 582 (1960). The Court must initially determine if there is a valid agreement to arbitrate between the parties, and whether the grievance before it is subject to arbitration. *Webb v. Investacorp., Inc.*, 89 F.3d 252, 257-8 (5th Cir. 1996); *Folse v. Richard Wolf Med. Instruments, Corp.*, 56 F.3d 603, 605 (5th Cir. 1995). State law contract principals are used to determine if there is a valid agreement to arbitrate. *First Options* of *Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995); *Webb*, 89 F.3d at 257. All doubts are resolved in favor of

arbitration. *Harvey v. Joyce*, 199 F.3d 790, 793 (5th Cir. 2000). Section 3 of the FAA provides for the stay of proceedings in federal district court when an issue is referable to arbitration. 9 U.S.C. § 3.

The Court must determine whether the parties agreed to arbitrate the dispute in question by considering whether there is a valid agreement to arbitrate between the parties and the dispute falls within the scope of the arbitration agreement. *R.M. Perez & Assoc., Inc. v. Webb*, 960 F.2d 534, 538 (5th Cir. 1992). The Court must grant the motion to arbitrate provided there is no rule of contract law which makes the arbitration clause or the contract unenforceable, and the dispute involves a matter arising out of the contract. 9 U.S.C. § 2. "[W]hether ... the company was bound to arbitrate, as well as what issues it must arbitrate is a matter to be determined by the Court on the basis of the contract entered into by the parties." *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 547 (1964). The court must also find that the arbitration clause in question is "susceptible of an interpretation that covers the asserted dispute." *United Steelworkers of Am. v. ASARCO, Inc.*, 970 F.2d 1448, 1450 (5th Cir. 1992). In this case the Court finds that the arbitration clause covers the parties' dispute regarding proper and timely completion of the construction contract.

A non-signatory to a contract containing an arbitration provision may compel arbitration against the signatory of that contract only if one of these conditions are met: (1) the signatory "raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract" or (2) the signatory

"must rely on the terms of the written agreement in asserting its claims against the non-signatory." *Grigson v. Creative Artists Agency, L.L.C.*, 210 F.3d 524, 527 (5th Cir. 2000), *reh'g en banc denied* 218 F.3d 745 & *cert. denied*, 531 U.S. 1013. The Court finds that the dispute regarding liability for the alleged default in the construction contract is precisely why the performance bond was procured. Accordingly, the Court further finds that RLI can move to enforce the arbitration clause even though RLI did not sign the construction contract.

Furthermore, when a performance bond incorporates the provisions of a contract, the arbitration provisions of the contract are made part of the bond and are applicable to disputes involving the surety. *J. S. & H. Constr. Co. v. Richmond County Hosp. Auth.*, 473 F. 2d 212, 216 (5th Cir. 1973). Although neither party provides reference to this well-settled rule, the Court has found that the performance bond specifically incorporates the construction contract as shown by the following:

> The Contractor and the Surety, jointly and severally, bind themselves, their heirs, executors, administrators, successors and assigns to the Owner for performance of the Construction Contract, which is incorporated herein by reference.

(Compl., Exh. A, p. 2, ¶ 1.)

Appendix 2

This provision renders Veranda Beach's claims subject to the arbitration clause. *See Smith v. Equifirst Corp.*, 117 F. Supp.2d 557, 566 (S.D. Miss. 2000). Accordingly, the Court concludes that RLI is entitled to seek enforcement of the arbitration clause. The arbitration clause at issue can easily be construed to cover the dispute between the parties concerning the alleged breach of contract. The Court, therefore finds that an order compelling arbitration should issue in this case. *See District 37 of Int'l Assn of Machinist & Aerospace Workers*, 897 F.2d 768, 773 (5th Cir. 1990). The Court further finds that the defendant's motion to stay these proceedings should be granted. It is therefore,

ORDERED AND ADJUDGED that defendant's motion to *stay this action* and compel the defendants to submit to arbitration [5-1, 5-2] to resolve a dispute between the parties be, and is hereby, granted. It is further,

ORDERED AND ADJUDGED that *the parties in this action submit the disputed matter to arbitration.* It is further,

ORDERED AND ADJUDGED that the Clerk of the Court is hereby directed *to close this action for statistical purposes* and place this case *on the inactive docket* of this court. It is further,

ORDERED AND ADJUDGED that *all parties shall file a status report* with the Court within ten days of the conclusion or arbitration, or in any event by no later than one year from the entry date of this order. *Failure to comply with this order may result in sanctions* as deemed appropriate by this court against the offending party. It is further,

Appendix 2

ORDERED AND ADJUDGED that *any party may move to reinstate this cause on the active docket* of this court at the conclusion of arbitration if necessary. It is further,

SO ORDERED AND ADJUDGED, this the 4th day of November, 2002.

s/ [illegible]
UNITED STATES DISTRICT JUDGE

No. 04-1297

IN THE

Supreme Court of the United States

VERANDA BEACH, LLC,

Petitioner,

v.

RLI INSURANCE CO.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN OPPOSITION

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CORPORATE DISCLOSURE STATEMENT

Respondent RLI Insurance Company's only parent corporation is RLI Corporation. There is no publicly held company that owns 10% or more of the corporation's stock.

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Appendix B — Arbitrators' Decision 14a

Respondent, RLI Insurance Company ("RLI"), opposes Veranda Beach, LLC's ("Veranda") petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in this matter on December 9, 2004.

OPINIONS BELOW

Veranda included the opinion of the Fifth Circuit that affirmed the district court at Appendix 1 of its petition. However, Veranda failed to include the final district court opinion that the Fifth Circuit affirmed. Therefore, the final opinion is included as Appendix A to this opposition brief. (Veranda included as its Appendix 2 the district court's earlier order compelling arbitration.)

RLI has included as Appendix B to this opposition brief the arbitrators' decision, the written findings and final award of which the district court opinion incorporated by reference. (District Court Opinion, Apr. 30, 2004, Res. App. 3a.)

STATEMENT OF THE CASE

Facts

In May 2000, Veranda and a general contractor signed a construction contract containing a mandatory arbitration agreement. The contractor was to build a condominium complex owned by Veranda in Biloxi, Mississippi. (Res. App. 1a.)

In June 2000, the contractor bought a performance bond from RLI, a surety. (Res. App. 2a.) The bond incorporated by reference the construction contract. The bond stated at paragraph 1:

> The Contractor and the Surety, jointly and severally, bind themselves, their heirs, executors, administrators, successors and assigns to the Owner

> for the performance of the Construction Contract, which is incorporated herein by reference.

(Performance Bond, R. 14[1], Pet. App. 8a.)

Only the contractor and RLI signed the performance bond, which bound the contractor and RLI to Veranda for performance of the construction contract. In the event of default by the contractor, the bond obligated RLI for, *inter alia,* correction of defective work (as measured by the construction contract) and for completion of the construction contract. The bond provided that any lawsuit against RLI be brought in a court of competent jurisdiction where the work was located. (Order, Pet. App. 3a.) (This is the provision Veranda refers to as "the judicial dispute resolution provision." (Pet. Br. at 2, 6.))

The contractor defaulted on the project in May 2001. (Res. App. 2a.) In June 2001, the contractor, Veranda, and RLI entered a Memorandum of Understanding ("MOU"), or takeover agreement (Res. App. 2a), providing that RLI would take over the project and arrange for the defaulted contractor to complete the work according to the terms of the construction contract, and that Veranda would agree to pay to RLI the balance of the contract price in accordance with the terms of the construction contract. (MOU, R.102, paras. 1-3, 6; SRE 2[2].) The bond's paragraph 3 stated that RLI's obligations under the bond did not arise until the owner made this agreement. (Bond, R. 14, para. 3; RE 6[3].)

The MOU required arbitration of disputes between any of the three parties. The MOU stated: "Upon full completion of the project, the parties will discuss and negotiate any claims

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1. "R" denotes the Record before the Fifth Circuit.

2. "SRE" denotes Supplemental Record Excerpts submitted to the Fifth Circuit.

3. "RE" denotes Record Excerpts submitted to the Fifth Circuit.

between the parties including but not limited to, liquidated damages, change orders, time extensions, claims by sub-contractors for extra work, etc. . . . All unreconciled disputes between the owner, the contractor and the surety will be resolved as provided by the [construction] Contract." (Order, Pet. App. 4a.) The construction contract in turn required arbitration.

RLI arranged for completion of the project. The city issued a Certificate of Occupancy on December 17, 2001. (Res. App. 2a.) (During the later arbitration of this case, the arbitrators found the project was substantially complete as of that date. (Res. App. 16a.))

Proceedings Below

On March 19, 2002, Veranda sued RLI, but not the contractor, in federal district court, making claims including defective, late, and incomplete work as measured against the terms of the construction contract. Veranda also made allegations of substantially interdependent and concerted misconduct by both RLI and the contractor. (Res. App. 2a.)

Upon RLI's motion, the court on November 5, 2002, compelled arbitration under the Federal Arbitration Act, 9 U.S.C.A. §§ 1 - 14. Under the doctrines of equitable estoppel and incorporation by reference, the court found RLI could move to enforce the construction contract's arbitration clause signed by Veranda and the contractor, even though RLI had not signed the construction contract. (Order, Nov. 5, 2002, Pet. App. 8a.)

After nine months of pre-trial preparation and litigating numerous motions, a five-day arbitration trial was held beginning June 9, 2003. (Res. App. 3a.) The three arbitrators, who were experts in the industry and/or construction law, ordered Veranda to pay RLI $237,154.71 and to pay 75% of the arbitration fees, costs, and expenses. (Arbitrators' Decision, Res. App. 21a-22a.)

Veranda moved to vacate the arbitration award, and RLI moved to affirm the award. In its motion to vacate, Veranda challenged, *inter alia*, the November 2002 order compelling arbitration. The district court found Veranda's challenge was a motion to alter or amend a prior order under Rule 60 of the Federal Rules of Civil Procedure and that Veranda had not met its burden of proof for such a motion. (Opinion, Res. App. 4a-5a.) The district court upheld the arbitration award on April 30, 2004. (Opinion, Res. App. 11a; Final Order & Judgment, Res. App. 12a-13a.)

Veranda appealed to the Fifth Circuit, claiming arbitrator bias in reaching a decision and arbitrator "misbehavior" in rulings on discovery motions. (Appellant's Original Brief before the Fifth Circuit, at 42-51, 57; Res. App. 5a-9a.) Veranda also challenged the bases for the order compelling arbitration, asked for a vacation of the arbitration order, and demanded a jury trial. (Appellant's Original Brief before the Fifth Circuit, at 13, 57; Res. App. 4a.)

After oral argument, the Fifth Circuit affirmed without written opinion the district court's decision to uphold the arbitration award. (Pet. App. 1a.)

Factual Misstatements by Veranda

First, in its Statement of the Case, Veranda speculates that, because the construction contract and the performance bond are both forms from the American Institute of Architects ("AIA"), they set up a "regime" for dispute resolution. (Pet. Br. at 4.) Veranda claims this regime requires disputes between an owner and a contractor to be arbitrated, and disputes between an owner and a surety to be litigated in court. (Pet. Br. at 4.) Veranda states that, in accordance with this regime, RLI and Veranda "agreed to resolve disputes in court." (Pet. Br. at 7.)

These claims are wrong, as has been recognized by the courts. See discussion at REASON V, *infra*, regarding *Gloucester City Board of Education v. American Arbitration Association,* 333 N.J. Super. 511, 522, 755 A.2d 1256, 1262, 126 Ed. Law Rep. 310 (Sup. Ct. N.J. 2000), and *Fidelity & Deposit Co. v Parsons & Whittemore Contractors Corp.*, 48 N.Y.2d 127, 421, 397 N.E.2d 380 (N.Y. App. 1979).

Second, in its Statement of the Case, Veranda incorrectly claims the "district court's order recognized problems in the formation and interpretation of the alleged arbitration provision in the *Memorandum of Understanding* and implicitly rejected it as a basis for arbitration." (Pet. Br. at 4.) However, under its findings, the court stated:

> RLI and Veranda Beach executed a memorandum of understanding on May 25, 2001, which provided in part as follows: ". . . All unreconciled disputes between the owner, the contractor, and the surety will be resolved as provided by the contract." (Order, Pet. App. 4a.)

The court went on to describe the arguments of the parties with regard to the MOU. (Order, Pet. App. 5a-6a.) The court made no "recognition" of "problems in the formation and interpretation" of the MOU's arbitration agreement.

Third, in its Statement of the case, Veranda incorrectly claims the district court's order "overrode the judicial dispute resolution provision" in the performance bond. (Pet. Br. at 6.) However, the district court made no holding "overriding" the judicial dispute resolution provision. The district court made its decision on only two independent bases: equitable estoppel and incorporation by reference, neither of which required or addressed "overriding" the judicial dispute resolution provision.

Fourth, Veranda goes on in its Statement of the Case to mischaracterize the district court's order. Veranda claims the

district court gave no explanation "why the arbitration provision in the Construction Contract was construed to create an arbitration agreement between Veranda and RLI." (Pet. Br. at 6.) However, Veranda claims the performance bond was a contract between Veranda and RLI, and the district court was clear in its finding that the performance bond incorporated by reference the construction contract and its arbitration clause. (Order, Pet. App. 8a-9a.)

Fifth, Veranda implies that RLI's role in this case is that of an insurer. (Pet. Br. at ii, 13.) Veranda claims that state law requires the performance bond and any ambiguities therein to be strictly construed against RLI, as it would be against an insurer. (Pet. Br. at 13.) Veranda is wrong.

This case is not about insurance, but about a surety bond. A division of RLI that operates as a surety, not as an insurance company, issued and sold to the contractor the performance bond at issue.

A surety undertakes to pay money or do any other act in the event its principal fails to perform. A surety is bound with its principal for performance of some duty or promise and is entitled to be indemnified by the one that ought to have performed. BLACK'S LAW DICTIONARY 1293 (5th ed. 1979). A surety bond involves three parties: surety (in this case, RLI), obligor or principal (in this case, the contractor), and obligee (in this case, Veranda). When a surety issues a performance bond on a construction contract, the surety agrees to "stand in the shoes" of the contractor with regard to contract obligations. *Gloucester,* 755 A.2d at 1262.

On the other hand, an insurer engages in the business of providing contracts by which the company (the insurer), for a valuable consideration, known as a premium, assumes a risk of loss or liability that rests upon the other party (the insured), pursuant to a plan for distribution of such risk. BLACK'S LAW DICTIONARY, *supra,* at 725, 295.

Another difference between an insurance company and a surety is that a surety is liable only in accordance with the strict terms of the surety bond, while, in contrast, all ambiguities in an insurance contract are construed against an insurer:

> In most jurisdictions, sureties are liable only in accordance with the strict terms of their undertaking. . . . *See, e.g., United States v. Seaboard Sur. Co.,* 817 F.2d 956, 963 (2d Cir.), *cert. denied,* 484 U.S. 855 (1987); *Monmouth Lumber Co. v. Indemnity Ins. Co. of N. America,* 21 N.J. 439, 452, 122 A.2d 604, 611 (N.J. 1956) and *Mendel-Mesick-Cohen-Architects v. Peerless Ins. Co.,* 426 N.Y.S.2d 124, 126 (N.Y. App. Div. 1980). . . . As one court has declared:
>
> > [T]he obligation of a surety is measured by the contract of surety. The surety's obligation cannot be extended by implication or enlarged by construction beyond the terms of the suretyship agreement. . . . *State of Florida ex rel. Westhinghouse Elec. Supply Co. v. Wesley Constr. Co.,* 316 F. Supp. 490, 497 (S.D. Fla. 1970), *aff'd by* 453 F.2d 1366 (5th Cir 1972). . . .

This doctrine of interpretation is **substantially different from that applicable to insurance policies where, generally, all ambiguities are construed against the carrier**. This is one of the reasons it is important to emphasize to claimants as well as judges and adversaries that **the surety, even if also an insurance company, is acting in its capacity as a surety**.

BOND DEFAULT MANUAL 3 (Duncan L. Clore ed., 2d ed., Tort & Insurance Practice Section, American Bar Assoc. 1995) (emphasis added).

REASONS FOR DENYING THE PETITION

I. RLI OBJECTS TO VERANDA'S FIRST QUESTION PRESENTED BECAUSE IT IS NOT GROUNDED IN THE FACTS OF THIS CASE.

RLI objects to the first question Veranda presents, which is, in effect, whether the Federal Arbitration Act prevents a federal district court from "overriding" a judicial disputes resolution provision in an AIA performance bond. (Pet. Br. at i.) However, there is no language in the district court's opinion in this case about overriding the judicial disputes resolution provision in the performance bond. The district court based its decision upon the two independent grounds of equitable estoppel and incorporation by reference. The district court did not reach any question concerning the "overriding" of a judicial dispute resolution provision.

The Fifth Circuit in this case affirmed without opinion, so it is not discernible what grounds the Fifth Circuit based its decision upon. As explained more at REASON VII. A, *infra*, RLI presented the Fifth Circuit with several alternative grounds for upholding the district court's judgment. Therefore, the facts of this case do not give rise to this question.

II. RLI OBJECTS TO VERANDA'S SECOND QUESTION PRESENTED BECAUSE THERE IS NO REAL CONFLICT BETWEEN THE FIFTH AND EIGHTH CIRCUITS.

A. *The Fifth Circuit has not rendered an opinion on allegedly conflicting judicial dispute resolution and arbitration provisions, as did the Eighth Circuit.*

RLI objects to the second question Veranda presents, which is, in effect, whether the Court should resolve an alleged conflict between the Fifth and Eighth Circuits over "conflicting judicial

dispute resolution and arbitration provisions" in an AIA performance bond and an AIA construction contract. (Pet. Br. at i.) The Eighth Circuit rendered an opinion in *AgGrow Oils v. National Union Fire Ins. Co.*, 242 F.3d 777 (8th Cir. 2001), that addressed this issue.

Again, the Fifth Circuit in the case below affirmed without opinion, so it is not discernible what grounds the Fifth Circuit based its decision upon, or whether the Fifth Circuit in the case at hand conflicts with the Eighth Circuit.

In addition, the allegedly conflicting Fifth Circuit opinion cited by Veranda (Pet. Br. at 14), *Grigson v. Creative Artists Agency, LLC*, 210 F.3d 524 (5th Cir. 2000), does not address any conflict between dispute resolution provisions in a performance bond and a construction contract, or in any standard-form contracts; it addresses only the application of equitable estoppel to compel arbitration in a non-construction-industry context, i.e., it involved a distribution agreement in the entertainment industry. Even Veranda attempts to distinguish the *Grigson* facts from those in *AgGrow*, by claiming there was no contract between the parties as there was in *AgGrow*. (Pet. Br. at 14.)

In applying equitable estoppel, *Grigson* correctly held that a signatory cannot

> "have it both ways": it cannot, on the one hand, seek to hold the nonsignatory liable pursuant to duties imposed by the agreement, which contains an arbitration provision, but, on the other hand, deny arbitration's applicability because the defendant is a nonsignatory. . . . [T]o allow such inconsistent positions would be inequitable, to say the least.

Grigson, 210 F.3d at 528.

Grigson further held that a nonsignatory can compel a signatory to arbitration under either of two circumstances, known

as the "intertwined claims" test: (1) equitable estoppel applies when the signatory (e.g., Veranda) to a written agreement containing an arbitration clause must rely on the terms of the written agreement in asserting its claims against the nonsignatory (e.g., RLI), or (2) equitable estoppel applies when the signatory (e.g., Veranda) to the contract containing the arbitration clause raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory (e.g., RLI) and a signatory (e.g., the contractor). As the Eleventh Circuit stated, "'Otherwise the arbitration proceedings between the two signatories would be rendered meaningless and the federal policy in favor of arbitration effectively thwarted.'" *MS Dealer Serv. Corp. v. Franklin,* 177 F.3d 942, 947 (11th Cir. 1999), *quoted in Grigson,* 210 F.3d at 527.

The district court below based one independent ground for its decision on *Grigson's* equitable estoppel analysis. The district court found that "the dispute regarding liability for the alleged default in the construction contract is precisely why the performance bond was procured. Accordingly, the Court further finds that RLI can move to enforce the arbitration clause even though RLI did not sign the construction contract." (Order, Pet. App. 8a.) In essence, the district court held that an owner, who is a signatory to a construction contract containing an arbitration agreement, and whose claims against a nonsignatory-surety arise from the terms of the construction contract, can be equitably estopped from asserting that the surety's being a nonsignatory precludes arbitration. Thus, the court found the first of the two *Grigson* conditions was met. [4]

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4. In addition, the second of the two *Grigson* conditions was met. The complaint in this case shows Veranda made many allegations of substantially interdependent and concerted misconduct by both RLI and the contractor, including failure to complete work in a timely manner, abandoning the job site, installing defective work, damaging condominiums under construction, misrepresenting claims for change orders, overcharging, fraud, etc. (R. 4-9; Res. App. 2a.) These allegations

(Cont'd)

The district court based the other independent ground for its decision on incorporation by reference, without discussing any conflict between dispute resolution provisions. The district court held the performance bond incorporated by reference the arbitration provision from the construction contract. (Pet. App. 8a.) The Fifth Circuit case relied upon by the district court for this second ground was *J.S.&H. Construction Co. v. Richmond County Hosp. Auth.*, 473 F.2d 212 (5th Cir. 1973). *J.S.&H.* does not address any conflict between dispute resolution provisions in a performance bond and a construction contract, or in any standard-form contracts; it addresses only incorporation by reference of an arbitration provision into a subcontract.

It can be seen that neither the Fifth Circuit in *Grigson* and *J.S.&H.*, nor the district court in its opinion below, addressed the issue raised in *AgGrow*.

B. *Subsequent Eighth Circuit cases appear to adopt use of equitable estoppel to compel arbitration similar to the Fifth Circuit.*

Veranda points to *AgGrow* as the Eighth Circuit case that allegedly conflicts with the Fifth Circuit. *AgGrow* addressed an alleged conflict between dispute resolution provisions in a performance bond and a construction contract. The Eighth Circuit looked to state-law contract interpretation principles to find that the performance bond did not incorporate by reference the arbitration provision from the construction contract. The Eighth Circuit did not ascertain whether the facts of the case raised the issue of equitable estoppel and thus did not apply equitable estoppel to compel arbitration.

However, the Eighth Circuit since then has applied, in *Dominium Austin Partners, LLC v. MJ Emerson*, 248 F.3d 720,

(Cont'd)

arose from the fact that, with Veranda's agreement (R.101), RLI hired the defaulted contractor to complete the work when RLI took over the job. (Res. App. 2a.)

728 (8th Cir. 2001), the doctrine of equitable estoppel to compel arbitration and even cited approvingly to cases that relied upon the "intertwined claims" basis for equitable estoppel. The "intertwined claims" basis was put forth by the Eleventh Circuit to allow a nonsignatory to compel arbitration against a signatory to an arbitration agreement, exactly the situation in the case at hand. *See MS Dealer Serv. Corp. v. Franklin,* 177 F.3d 942, 947 (11th Cir. 1999); *McBro Planning & Development Co. v. Triangle Electrical Construction Co., Inc.,* 741 F.2d. 342 (11th Cir. 1984). These Eleventh Circuit cases were the ones the Fifth Circuit in *Grigson* looked to when adopting the "intertwined claims" test. *Grigson*, 210 F.3d at 527. The "intertwined claims" test was relied upon by the district court below to compel arbitration.

The Eighth Circuit decided *Dominium* in May 2001, two months after it decided *AgGrow* in March 2001. *Dominium* held that signatories to a partnership agreement containing an arbitration clause could be compelled to arbitration against non-signatories to the agreement. Mirroring the Fifth Circuit's reasoning in *Grigson*, the Eighth Circuit held: "It would be inequitable to allow appellants [signatories] to claim that these parties [non-signatories] are liable for failure to perform under a contract and at the same time to deny that they are contractual parties in order to avoid enforcement of the arbitration clause." *Dominium*, 248 F.3d at 728.

The Third Circuit in *E.I. DuPont de Nemours v. Rhone Poulenc Fiber,* 269 F.3d 187, 202 (3rd Cir. 2001), noted the Eighth Circuit's holding in *Dominium* as one in a line of cases where "'the circuits have been willing to estop a *signatory* from avoiding arbitration with a nonsignatory when the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed.'" (Emphasis in original.) The Second Circuit has noted that courts have held that signatories were "estopped from avoiding arbitration because they had entered into written arbitration

agreements, albeit with the affiliates of those parties asserting the arbitration and not the parties themselves." *Thomson-CSF, SA v. American Arbitration Assoc.*, 64 F.3d 773, 779 (2d Cir. 1995).

Based upon *Dominium*, the Fifth Circuit in *Washington Mutual Finance Group, LLC v. Bailey*, 364 F.3d 260, 267 (5th Cir. 2004), recognized the Eighth Circuit as one of the "[n]umerous federal circuit courts ... [that] have recognized the operation of the doctrine of equitable estoppel on non-signatories in an arbitration context." The Fifth Circuit also recognized the Fourth, Seventh, and Eleventh Circuits.

A district court in the Eighth Circuit declined to apply *AgGrow* in a case similar to the one at hand, where a performance bond incorporated by reference a construction contract containing an arbitration provision: *Taylor Ridge Estates, Inc. v. Statewide Insurance Co.*, No. Civ. 4-01-DV-90058, 2001 WL 1678745 (S.D. Iowa Oct. 1, 2001). Instead, the *Taylor* court appeared to apply equitable estoppel and reconciled it with *AgGrow*. The court agreed with the Eighth Circuit in *AgGrow* that

> the Surety cannot be made to arbitrate claims solely based upon interpretation of the Performance Bond, which contains no arbitration provision. But to the extent that [the owner's] claims are dependent upon defining [the owner's] duties or the Surety's secondary obligations under the Construction Contract, the Surety is bound to arbitrate.

Taylor, supra, at *8. The *Taylor* court[5] elaborated, "Given the

5. The *Taylor* court sought to distinguish *AgGrow* by stating: "Unlike *AgGrow*, where one party resisted full incorporation, [the owner] and the Surety both seek the benefits of fully incorporating the Construction Contract into the Performance Bond – [the owner] for the purpose enforcing the arbitration clause, and the Surety for purposes of (Cont'd)

terms of the Construction Contract, the related incorporation of that contract into the Performance Bond and the fact that the Surety has relied upon other favorable provisions in the Construction Contract, it is the belief of this Court that the Surety is a proper participant in this arbitration." *Id.*

Although Veranda claims there is uncertainty "in the construction industry" regarding the meaning of the terms of the performance bond and the construction contract (Pet. Br. at 16), the clarity of the *Taylor* holding shows there is not.

RLI has found no case that has followed *AgGrow's* holding when a signatory sues a nonsignatory on claims intertwined with a contract containing an arbitration clause. It is arguable that the *AgGrow* holding may be anomalous and limited to its facts. This Court has in effect stated it will not grant certiorari to address problems that are academic or episodic. *Rice v. Sioux City Memorial Park Cemetary,* 349 U.S. 70, 74, 75 S. Ct. 614, 616, 99 L. Ed. 897 (1955). This Court should not do so in the present case.

Based upon the reasons above, there appears to be no real conflict among the circuits. Thus, neither the facts of this case nor the circuit court decisions cited by Veranda give rise to Veranda's second question presented.

(Cont'd)

barring consequential damages." *Taylor, supra,* at *8. In the case at hand, both parties similarly are required to seek the benefits of relying upon the construction contract in order to bring their claims. Veranda must rely on the contract terms to establish any claims of defective, late, or incomplete work. RLI also relied upon the contract terms to bring its counterclaims (including those for delays) and to enforce the arbitration clause against Veranda.

III. THIS COURT SHOULD NOT REVIEW THE ISOLATED DISTRICT COURT OPINION BELOW.

Because there is no Fifth Circuit opinion that addresses the same issue as *AgGrow* (allegedly conflicting judicial dispute resolution and arbitration provisions), Veranda tries to assert that the opinion of the district court below does. (*See* REASON I, *supra*, for why Veranda is incorrect.) Veranda in effect is asking this Court to review the isolated district court opinion below. This is not a proper ground for certiorari, as identified in Rule 10.

IV. VERANDA'S ALLEGED GROUNDS FOR CERTIORARI ARE MERELY COMPLAINTS ABOUT A DISTRICT COURT'S APPLICATION OF A PROPERLY STATED RULE OF LAW.

A. *Veranda complains about use of equitable estoppel and incorporation by reference.*

This Court's Rule 10 states that a petition for a writ of certiorari is rarely granted when the asserted error consists of the misapplication of a properly stated rule of law. Yet, that is all Veranda's complaint amounts to.

Veranda identifies the complaint at the heart of its petition: the district court "employed the doctrines of equitable estoppel and incorporation by reference to compel arbitration . . ." (Pet. Br. at 7.) Veranda complains that equitable estoppel should not have been used in this case (Pet. Br. at 14), but that ordinary state-law principles governing formation of contracts should have been (Pet. Br. at 13). Veranda claims the district court "contravened several of Mississippi's fundamental rules for contract interpretation." (Pet. Br. at 13.) Veranda requests this Court to instruct lower courts "not to ignore or misapply state law . . ." (Pet. Br. at 13.)

It is clear that Veranda is complaining about the application of the doctrine of equitable estoppel, which the district court properly stated from *Grigson, supra,* and the application of

incorporation by reference, which the district court properly stated from *J.S.&H., supra.* (Order, Pet. App. 7a-8a.) In accordance with Rule 10, this Court should not entertain this complaint.

In addition, this Court rarely reviews a construction of state law agreed upon by two lower courts. The Court believes that the federal district and circuit courts are better schooled in, and more able to interpret, the laws of their respective states. *Frisby v. Schultz*, 487 U.S. 474, 482 (1988). In analogy to this reasoning, RLI believes this Court should defer to the district court's application and/or interpretation of Mississippi contract law and deny certiorari.

B. ***The circuits have already correctly addressed when to use state-court contract formation principles and when to use federal doctrines like equitable estoppel in an arbitration context.***

In support of its argument against equitable estoppel, Veranda quotes from this Court's holding in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U S. 395, 404 n.12 (1967): "[T]he purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so." (Pet. Br. at 9.) Veranda argues that this means courts are only to use state-law principles governing formation of contracts to determine whether arbitration should be compelled. (Pet. Br. at 13.) Veranda believes that is what the Eighth Circuit in *AgGrow* did.

The circuits have already addressed the issue of when to use state-court contract formation principles and when to use federal doctrines like equitable estoppel. The Fifth Circuit in *Washington Mutual* noted that "whether a court should apply state law [as did the *AgGrow* court] or 'the federal substantive law of arbitrability'" (which includes the doctrine of equitable estoppel outlined by the federal courts) is an issue in determining whether a party should be compelled to arbitrate its claims

against another. *Washington Mutual,* 364 F.3d at 267, n. 6. The court observed that nearly all federal circuit courts – **including the Eighth Circuit** – faced with the question of whether a nonsignatory can be bound to an arbitration provision have applied the federal substantive law of arbitrability to resolve the issue. *Id.*

The Fifth Circuit adopted the Fourth Circuit's reasoning in *International Paper Co. v. Schwabedissen Maschinen & Anlagene GMBH,* 206 F.3d 411, 417-18 (4th Cir. 2000): "[B]ecause **the determination of whether a nonsignatory is bound by an arbitration provision 'presents no state law question of contract formation or validity,'** a court should 'look to the federal substantive law of arbitrability to resolve this question." *Washington Mutual,* 364 F.3d at 268, n.6 (emphasis added).[6] The federal substantive law of arbitrability includes using the doctrine of equitable estoppel to compel arbitration.

It is apparent that, without basis, Veranda disagrees with the Fourth and Fifth Circuits that the determination of whether a nonsignatory is bound by an arbitration provision "presents

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6. The Fifth Circuit also cited to the Second Circuit's analysis in *Thomson-CSF,* 64 F.3d at 776, of when non-signatories may be bound to arbitration agreements, regardless of state-law contract formation principles:

> As the Second Circuit has accurately noted, while arbitration is contractual by nature:
>
> > It does not follow . . . that under the [Federal Arbitration] Act an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision. [We have made] clear that a nonsignatory party may be bound to an arbitration agreement if so dictated by the ordinary principles of contract and agency.

Washington Mutual, 364 F.3d at 267 (alterations in original).

no state law question of contract formation or validity." Despite Veranda's contentions, even the Eighth Circuit has acted consistently with this pronouncement. *Dominium*, *supra*; *Taylor*, *supra*, and applied equitable estoppel to compel arbitration.

At the end of the day, Veranda merely disagrees with the district court's application in this case of the properly stated doctrines of equitable estoppel and incorporation by reference.

C. *Use of equitable estoppel is the district court's discretionary call.*

The Fifth Circuit held that whether to utilize equitable estoppel to compel arbitration is within a district court's discretion; the federal circuits will review only to determine whether that discretion has been abused. "To constitute an abuse of discretion, the district court's decision must be either premised on an application of the law that is erroneous, or on an assessment of the evidence that is clearly erroneous." *Grigson*, 210 F.3d at 528; *Hill v. GE Power Systems, Inc.*, 282 F.3d 343, 348 (5th Cir 2002); *Bridas SAPIC v. Gov. of Turkmenistan*, 345 F.3d 347, 360 (5th Cir. 2003).

As there has been no erroneous application of the law or erroneous assessment of evidence, reviewing courts should defer to the district court's decision in the case at hand. As the Fifth Circuit stated, "In sum, the district court is better equipped to make the call than this court, and we do not lightly override that discretion." *Hill*, 282 F.3d at 349.

V. VERANDA MISLEADS THE COURT BY ASSERTING THE DISTRICT COURT'S HOLDING IN THIS CASE "REWRITES" STANDARD AIA FORMS USED INDUSTRY-WIDE.

In an attempt to manufacture an issue of public import, Veranda incorrectly asserts that the district court's holding "potentially replaces the judicial dispute resolution provision in all [AIA (American Institute of Architects) Form A312]

performance bonds with compulsory arbitration." (Pet. Br. at 10.) Veranda questions why, as a matter of public policy, should sureties be allowed to compel arbitration "whenever they prefer" by using equitable estoppel, incorporation by reference, or any other doctrine. (Pet. Br. at 11.) Veranda reiterates its speculation that the performance bond and construction contract establish an industry-wide regime that requires all disputes between an owner and a surety to be judicially resolved and those between an owner and a contractor to be arbitrated. (Pet. Br. at 11.)

Veranda's assertion that the district court's holding replaces the judicial dispute resolution provision in all AIA performance bonds with compulsory arbitration is simply not true. Neither is Veranda's implication that sureties can arbitrarily compel arbitration whenever they want and without basis. *Grigson* and the other federal circuit cases applying equitable estoppel make it clear that arbitration can only be compelled when the "intertwined claims" test is satisfied. I.e., one of the following conditions must be met: (1) the signatory raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract, or (2) the signatory must rely on the terms of the written agreement in asserting its claims against the nonsignatory. *Grigson*, 210 F.3d at 527. (Order, Pet. App. 7a.) It is only when these circumstances are present that fairness requires the signatory be estopped from avoiding the written arbitration agreement it signed.

Veranda's speculation about an industry-wide regime is ill-founded. If there is any such regime, it is what the courts in *Gloucester,* 755 A.2d at 1262, and *Fidelity,* 397 N.E.2d at 380, described. Those courts found that the performance bond's incorporation by reference of the construction contract meant that the surety was required to arbitrate disputes relating to performance of the construction contract, but not disputes arising under the bond that were not related to performance of the construction contract.

The court in *Gloucester* cited to a line of cases holding that

> the intent of an arbitration clause in the underlying contract is to require the submission to arbitration of any dispute concerning the adequacy of the contractor's performance, and when a performance bond incorporates the terms of contract by reference, it constitutes an agreement by the surety to stand in the shoes of the principal [contractor] in the event a claim is made under the bond, and to arbitrate any issue concerning the principal's performance of the contract.

The court held the surety was required to arbitrate any dispute the contractor would have been required to arbitrate, but was not required to arbitrate any disputes between the surety and the owner not related to contract performance. As in the present case, the bond in *Gloucester* had a judicial disputes resolution provision. *Gloucester,* 755 A.2d at 1262, 1259, 1260, 1265.

In *Fidelity,* another court in a different state recognized there is a distinction between requiring a surety that has executed a bond for performance of a construction contract containing an arbitration clause to arbitrate disputes concerning performance of the contract, and requiring the surety to arbitrate disputes concerning the enforceability of its performance bond. The court held the surety was required to arbitrate disputes relating to performance of the construction contract, but not disputes arising under the bond that were not related to performance of the construction contract. *Fidelity,* 397 N.E. 2d at 382.

A court should read a contract as a whole and interpret a contract to give meaning and effect to all terms. *Warwick v. Gautiee Utility District,* 738 So.2d 212, 215 (Miss. 1999). The interpretations of the *Gloucester* and *Fidelity* courts give meaning and effect to all terms of the performance bond and construction contract at issue. Therefore, this Court should give weight to the carefully considered interpretations of those courts, especially over the unfounded speculations of Veranda.

Veranda is wrong about the industry-wide regime, and the district court's holding does not rewrite an industry-wide regime as claimed by Veranda.

VI. THE DISTRICT COURT'S HOLDING DID NOT DEPRIVE VERANDA OF ITS CONSTITUTIONAL RIGHTS.

Veranda claims the district court's holding deprived it without notice of its Fifth Amendment right to due process in a court of law and its Seventh Amendment right to a jury trial. (Pet. Br. at 12.) However, this Court has stated it has a duty to avoid decision of constitutional issues unless avoidance becomes evasion. *Rice,* 349 U.S. at 74. In addition, this Court does not sit for the benefit of the particular litigants affected by the district court opinion in this case. *Id.*

Veranda claims the performance bond gave it, as the obligee, the right to institute "any proceeding, legal or equitable, under this Bond . . . in any court of competent jurisdiction" where the construction project was located. (Pet. Br. at 12.) However, there is no language in the bond *per se* giving any party the right to institute such a proceeding. The bond does establish rules for forum-selection and timeliness of filing. Section 9 states:

> Any proceeding, legal or equitable, under this Bond may be instituted in any court of competent jurisdiction in the location in which the work or part of the work is located and shall be instituted within two years after Contractor Default or within two years after the Contractor ceased working or within two years after the Surety refuses or fails to perform its obligations under this Bond, whichever occurs first.

(R.14, RE 6; Pet. Br. at 2-3.)

In any event, as established above in REASON V, arbitration could only be compelled because Veranda's own actions provided the basis for satisfying the "intertwined claims" test.

In addition, Veranda knew it was a signatory to the underlying construction contract containing the arbitration clause, and Veranda also knew it later signed a third document, the MOU, that specifically provided that disputes between any of the three parties (owner, contractor, or surety) would be resolved in accordance with the procedures in the construction contract. (Pet. App. 4a.) Although these facts show Veranda knowingly waived any right to a jury trial, it is not necessary to decide any constitutional issues raised by Veranda when this case can be resolved by looking to the MOU. *Brockett re Spokane Arcade,* 472 U.S. 491, 501 (1985) (it is a cardinal rule governing federal courts never to anticipate a question of constitutional law in advance of the necessity of deciding it). This is elaborated more in Reason VII, *infra.*

VII. EVEN IF THERE WERE A CONFLICT BETWEEN THE CIRCUIT COURTS OR A FEDERAL QUESTION, THIS IS NOT THE CASE TO RESOLVE IT.

Even if there were a conflict between the Fifth and Eighth Circuits or a question involving the Federal Arbitration Act, this case is not the one to resolve it, for the following reasons.

A. *This case can be decided on alternative grounds.*

Before the district court and the Fifth Circuit, RLI offered several grounds for affirming the decision to compel arbitration. One was that Veranda, RLI, and the contractor signed an MOU, or takeover agreement, that clearly incorporated the construction contract's disputes resolution provision. That provision included a mandatory arbitration clause and made it applicable to all three parties. (Order, Pet. App. 4a.) They signed the MOU after Veranda and the contractor signed the construction contract, and after RLI and the contractor signed the performance bond. (Opinion, Res. App. 2a; Order, Pet. App. 4a.) RLI asked the Fifth Circuit to find as a matter of law that the MOU clearly and unambiguously incorporated the binding arbitration clause.

As the Fifth Circuit issued no written opinion in this case, it is not discernible on what grounds the Fifth Circuit affirmed the district court's decision to compel arbitration. Based upon the Fifth Circuit's interest in the MOU issue during oral argument, it could well have affirmed on that ground, and not on the equitable estoppel and incorporation by reference grounds relied upon by the district court and presented by Veranda in its questions for certiorari.

This case can still be decided on the MOU issue, without ever reaching the questions of whether equitable estoppel and incorporation by reference are appropriate in this case.

B. ***Deciding for petitioner will not reverse this case.***

If the Court were to grant certiorari and ultimately agree with Veranda that the district court should not have applied equitable estoppel or incorporation by reference to compel arbitration, the appropriate disposition would be to remand for decision on whether the MOU as a matter of law required arbitration.

RLI believes the MOU clearly and unambiguously incorporates the construction contract's arbitration clause. However, if the lower court should decide it was not clear, then the appropriate disposition would be to hold an evidentiary hearing on the intent behind the disputes resolution language in the MOU.

If the MOU were found not to require arbitration, then Veranda has made clear it intends to demand a federal jury trial. Veranda has already had one bite at the apple, where it fully litigated all of its claims on the merits in a five-day arbitration. The expensive arbitration took nine months of pretrial preparation, including litigating several motions and conducting many depositions. Three arbitrators, who were experts in the industry and/or construction law, ordered Veranda to pay RLI $237,154.71 and to pay 75% of the arbitration fees, costs, and

expenses. (Arbitrators' Decision, Res. App. 21a-22a.) Veranda is dissatisfied, and now wants a second bite at the apple.

Deciding for Veranda would only drag out a costly, protracted litigation even further and retry issues that have already been fully heard and fairly decided. This would not be an efficient use of already-strained judicial resources.

C. *Veranda should not be allowed to avoid arbitration by suing only the surety.*

As pointed out in footnote 4, *supra*, Veranda made many allegations of substantially interdependent and concerted misconduct by both RLI and the contractor, including failure to complete work in a timely manner, abandoning the job site, installing defective work, damaging condominiums under construction, misrepresenting claims for change orders, overcharging, fraud, etc. (R. 4-9; Res. App. 2a.) These allegations arose from the fact that, with Veranda's agreement (R.101), RLI hired the defaulted contractor to complete the work when RLI took over the job. (Res. App. 2a.)

It is worth note that Veranda did not name the contractor as a defendant in this lawsuit. This Court should not let Veranda avoid the arbitration clause in the construction contract it signed by suing only the surety, and not the contractor who actually performed the allegedly untimely and defective work, and participated in the alleged misconduct.

When such interdependent allegations are made, as the Fifth Circuit found, the signatory-contractor – even though not sued – in essence becomes a party, with resulting loss of time and money because of its required participation in the proceeding. Concomitantly, detrimental reliance by the signatory-contractor cannot be denied:

> it and the signatory-plaintiff [in this case, Veranda] had agreed to arbitration in lieu of litigation (generally far more costly in terms of time and

> expense); but, the plaintiff is seeking to avoid that agreement by bringing the action against a nonsignatory [in this case, RLI] charged with acting in concert with that non-defendant signatory [in this case, the contractor].

Grigson, 210 F.3d at 528.

These are conditions ripe for the application of equitable estoppel.

CONCLUSION

For the foregoing reasons, the Court should deny the petition for certiorari.

Respectfully submitted,

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APPENDIX

APPENDIX A — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF MISSISSIPPI, SOUTHERN DIVISION FILED APRIL 30, 2004

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF MISSISSIPPI
SOUTHERN DIVISION

CIVIL ACTION NO. 1:02CV110SR

VERANDA BEACH, L.L.C.

PLAINTIFF

V.

RLI INSURANCE COMPANY

DEFENDANT

MEMORANDUM OPINION

This action arises from a dispute concerning the performance of a construction contract. The case is before the Court for review of the decision of an arbitration panel.

Facts

Plaintiff Veranda Beach, L.L.C. (Veranda), a Mississippi limited liability company, is the owner of and developer of the Magnolia Shores Condominium project in Biloxi, Mississippi. In May 2000, Veranda hired United Contractors (United) to build these condominiums. The construction

contract contained an arbitration clause. In June 2000, Defendant RLI Insurance Company (RLI) issued a performance bond covering this project. The performance bond did not contain an arbitration clause.

The project did not go smoothly. There were substantial delays. Veranda ultimately declared United to be in default under the construction contract and called upon RLI to complete the project. In May 2001, Veranda and RLI circulated a "Memorandum of Understanding." Although this agreement was signed by representatives of both RLI, United, and Veranda, there is a dispute whether the parties ever agreed to a single set of terms. RLI took over the project, and, with the consent of Veranda, RLI re-hired United to complete construction of this project. On December 17, 2001, the City of Biloxi issued its certificate of occupancy.

Veranda has never considered the construction of this project complete. Veranda contends that RLI and United abandoned the project. Veranda withheld a large portion of the contract price, and this litigation ensued.

Proceedings in this Court

Veranda filed its complaint against RLI in March 2002. Veranda sought damages for cost overruns, delay damages, and punitive damages based on allegations of fraud. RLI moved to compel arbitration. On November 5, 2002, the Court granted RLI's motion to compel arbitration. While RLI's motion to compel arbitration was pending, both Veranda and RLI commenced state court proceedings related

to RLI's construction lien on the project. The state court actions were stayed, by agreement, pending the outcome of arbitration.

The Arbitration

Arbitration was conducted June 9-13, 2003. In July 2003, the arbitrators rendered their decision, awarding the unpaid contract balance and compensation for certain change orders to RLI, less certain credits for Veranda Beach. The arbitrators found mutual fault for the construction delays and declined to award delay damages to either party. The arbitrators made a net award to RLI of approximately $237,000. The Arbitrator's written findings and final award are incorporated into this opinion by reference.

Issues Now Before the Court

The primary issue now before the Court is whether the arbitrators' award should be confirmed or set aside. Veranda seeks to have the arbitrators' award set aside, and RLI asks that the award be confirmed.

Veranda presents three grounds in support of its motion to set aside the arbitrators' award. Veranda contends that:

1. The Court erred in ordering that this matter be submitted for arbitration;

2. The arbitrators were biased in favor of RLI; and

3. The arbitrators erred in failing to award delay damages.

Appendix A

Standard of Review

A court considering the validity of an arbitration award applies a deferential standard of review. *Glover v. IBP, Inc.*, 344 F.3d 471 (5th Cir. 2003). The party moving to vacate an award has the burden of proof. *Spector v. Torenberg*, 852 F.Supp. 201, 206 (S.D.N.Y. 1994). Review is limited to a determination of fundamental fairness in the arbitration proceeding. *Williams v. Cigna Financial Advisors, Inc.*, 197 F.3d 752 (5th Cir. 1999).

The Federal Arbitration Act (FAA) provides that an arbitration award may be vacated only if: (1) the award was procured by corruption, fraud, or undue means; (2) there is evidence of partiality or corruption among the arbitrators; (3) the arbitrators were guilty of misconduct that prejudiced the rights of one of the parties; or (4) the arbitrators exceeded their powers. 9 U.S.C. § 10(a). An additional non-statutory ground for vacating an arbitration award is that the arbitrators acted with "manifest disregard of the law." This additional ground, not found in the FAA, is extremely narrow, and implies a gross departure from clearly established legal principles. *Prestige Ford v. Ford Dealers Computer Services, Inc.*, 324 F.3d 391 (5th Cir. 2003).

Order Granting RLI Motion To Require Arbitration

Veranda contends that this Court's November 5, 2002, order granting RLI's motion to require arbitration was erroneous. Although this order was entered by Judge Gex, who was presiding in this case at that time, it is nevertheless the order of this District Court. This Court's authority to alter

or amend a prior order is governed by Rule 60 of the Federal Rules of Civil Procedure. Veranda does not assert any of the six grounds for relief set out in Rule 60. Veranda does not allege that the order requiring arbitration was the result of "mistake, inadvertence, surprise, or excusable neglect"; it presents no new evidence; it does not allege "fraud . . . misrepresentation or other misconduct" by RLI; it does not allege that the order is void; it does not allege that the order has been released or discharged by RLI; and it does not assert any other reason or grounds for the relief it is seeking that was not presented in opposition to RLI's original motion.

In essence, Veranda is asking this Court to sit as an appellate court and review the validity of the order entered on November 5, 2002. This is an invitation I will decline. I am of the opinion that there were good grounds in fact and law for Judge Gex's decision to require that this matter be submitted to arbitration, and I do not believe that Veranda has met its burden of proof under Rule 60. Accordingly, considering the first grounds for relief asserted by Veranda as a motion for relief from the Court's November 5, 2002, order under Rule 60, that motion will be denied.

Bias of Arbitrators

Veranda has asserted that the arbitrators in this case were partial to RLI. Most of Veranda's contentions on this point relate to the Chairman of the arbitration panel, Pat Scanlon (Scanlon), but Veranda also alleges that there are grounds to question the impartiality of the other two arbitrators, John H. Allgood, III, (Allgood) and Craig Kaster (Kaster). If Veranda can prove this contention, it would have grounds

for relief under § 10(a) of the FAA. Evidence of partiality among the arbitrators is a specific statutory ground for relief under the act.

Veranda's contentions concerning Scanlon are based upon what it perceives to be a web of relationships among Scanlon, RLI, Bottrell Insurance Agency (Bottrell), and Trustmark Bank (Trustmark). Veranda contends that these relationships were not disclosed prior to the mediation, in violation of the rules of the American Arbitration Association.

Bottrell was the agent for the sale of the RLI completion bond that covered the condominium construction project at issue. Trustmark now owns Bottrell. Pat Scanlon now works for a law firm (Watkins & Eager) that represents Trustmark.

During the arbitration hearings, RLI produced a copy of the construction contract that had been faxed to Bottrell during contract negotiations, and by using the fax date stamp on this document, RLI was able to impeach one of Veranda's witnesses concerning a key date. Veranda has not shown that the document was procured by illegitimate means or that it could not have procured this same document from Bottrell during the discovery phase of the arbitration proceeding. Neither Trustmark nor Bottrell was a party or a witness in the arbitration proceeding. Bottrell came into possession of this document in its capacity as the agent for the sale of the RLI performance bond.

At the end of the arbitration hearing, which was conducted in Biloxi, Mississippi, Pat Scanlon acceded to a request by counsel for RLI that he return certain original

documents that had been part of the arbitration proceedings to Bottrell. Bottrell is headquartered in Jackson, Mississippi, where Scanlon lives. Veranda contends that this is evidence of an improper relationship between RLI and Scanlon.

Before the arbitration, Scanlon disclosed that he was representing a client who was negotiating a construction bond with RLI. Veranda did not make any objection to Scanlon's participation in the arbitration based upon the disclosures he made prior to the arbitration proceedings.

At the time he was appointed an arbitrator in this case, Scanlon was a member of the law firm Scanlon, Sessums, Parker, & Dallas. At some point before the arbitration was completed, Scanlon joined the law firm of Watkins & Eager. Watkins & Eager maintains a relationship with Trustmark. Veranda contends that Scanlon's partiality to RLI arises from his law firm's (Watkins & Eager) representation of Trustmark Bank, which owns Bottrell.

Neither Trustmark nor Bottrell was identified by Veranda or by RLI as interested parties at the time the arbitration proceedings commenced. Since neither party identified Trustmark or Bottrell as interested parties, it is difficult to see how Scanlon or either of the other arbitrators could have had any duty to disclose their relationships, if any, with these businesses. Indeed, it appears to me that neither Trustmark nor Bottrell has any interest in the outcome of this controversy.

I do not perceive in this record any substantial evidence of bias or partiality on the part of Pat Scanlon. Since neither

Appendix A

Trustmark nor Bottrell was in any way interested in the merits of the matter under arbitration, i.e. in the performance of the RLI bond and the underlying construction contract or in the conflicting claims and counterclaims for damages for breaches of these undertakings, I do not believe there is any reasonable basis to question Pat Scanlon's impartiality based on his relationship with the firm that represents Trustmark Bank. Likewise, I do not believe that Scanlon's agreeing to return a file to Bottrell as a courtesy to one of RLI's attorneys is evidence of bias or partiality on his part. As to the facts disclosed by Scanlon prior to the arbitration, Veranda has waived any objection it may have had by its failure to raise its objection in a timely manner.

As to Allgood, Veranda points out that his (Allgood's) construction company was doing business with RLI by completing a construction project under an RLI performance bond. Allgood disclosed this before the arbitration proceeding, and Veranda raised no objection. If Veranda had an objection on the grounds of this disclosure, it has, in my opinion, waived that objection.

As to Kaster, Veranda points out that he attended West Point Military Academy with E.B. Williams, RLI's Director of Bond Claims, who was one of the witnesses at the arbitration proceedings. Kaster disclosed that at the time Kaster was called to testify, and Veranda raised no objection. If Veranda had an objection on the grounds of this disclosure, it has, in my opinion, waived that objection.

Appendix A

The Refusal To Award Delay Damages

The arbitrators made a specific finding that the delays in this construction contract were the result of fault on the part of four parties: Veranda, its architect, United, and RLI. In these circumstances, the arbitrators found that neither of the parties should be awarded delay damages. If this determination is not a "manifest disregard of the law," the decision must be upheld. *Prestige Ford v. Ford Dealers Computer Services Inc.*, 324 F.3d 391 (5th Cir. 2003).

The Mississippi authorities I have examined establish the right of an aggrieved party to recover delay damages when there is proof that the damages are attributable to the fault of the other party to the construction contract. See *Mississippi Transp. Comm'n v. SCI, Inc.*, 717 So.2d 332 (Miss. 1998); *Mississippi Transp. Comm's v. Ronald Adams Contractor, Inc.*, 753 So.2d 1077 (Miss. 2000). Authorities from other jurisdictions establish the fundamental and sound rule that the party seeking to collect damages for delay must bear the burden of proving causation, i.e. the party seeking to establish a right to recover damages for construction delays must satisfy the finder of fact that the delays were attributable to the action or inaction of the adverse party. See *Fieldcrest Builders, Inc. v. Antonucci*, 724 N.E.2d 49 (Ill. App. 1999).

Both Veranda and RLI sought an award of delay damages. The arbitrators found, as a fact, that the delays in this project were jointly attributable to Veranda, its architects, United, and RLI. Based on this finding, the arbitrators declined to award damages to either party. While this approach may not be the only reasonable way this issue could have been

resolved, this Court's review of the arbitrators' decision is limited to a determination whether the arbitrators "ignored the existence of any clearly governing [legal] principle in reaching its award." *Prestige Ford v. Ford Dealer Computer Services, Inc.*, 324 F.3d 391 at 396 (5th Cir. 2003). In my opinion the arbitrators acted within their authority in making the factual determination that neither party had proved its claims for delay damages, and I find that there has been no manifest error of law in this aspect of the arbitration.

Conclusion

For the reasons set out above, I find that Veranda has not proved any of the statutory grounds that would justify setting aside the award of the arbitrators under 9 U.S.C. § 10(a), and I find that there has been no manifest error of law committed by the arbitrators in making their award. There is no substantial evidence in this record to support an inference of bias or partiality on the part of any of the arbitrators. There are no grounds for relief from the November 5, 2002, order requiring that this matter be submitted to arbitration. The award of the arbitrators will therefore be confirmed.

Accordingly, it is

ORDERED

That the motion of Veranda Beach, L.L.C., for a hearing on its motions [21-1] is hereby **DENIED AS MOOT** in light of the hearing conducted on March 9, 2004;

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That the motion of Veranda Beach, L.L.C., to vacate the arbitration order [27-1] is hereby **DENIED**;

That the motion of RLI to submit additional exhibits [39-1] is hereby **GRANTED**;

That the motion of RLI for leave to file supplemental affidavit [41-2] is hereby **GRANTED**.

That motion of RLI to strike [41-1] is hereby **DENIED**.

That the motion of RLI to reinstate this case to the active docket for the purpose of confirming arbitration award and issuance of judgment [21-1] is hereby **GRANTED**;

That the award of the arbitrators is hereby **CONFIRMED**; and

That a separate judgment will be entered upon the award of the arbitrators.

SO ORDERED this 29th day of April, 2004.

s/ L.T. Senter, Jr.
L.T. Senter, Jr.
Senior Judge

Appendix A

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF MISSISSIPPI
SOUTHERN DIVISION

CIVIL ACTION NO. 1:02CV110SR

VERANDA BEACH, L.L.C.

PLAINTIFF

V.

RLI INSURANCE COMPANY

DEFENDANT

ORDER AND JUDGMENT CONFIRMING ARBITRATION AWARD

This matter was referred to arbitration by Order of this Court on November 5, 2002. An arbitration hearing was conducted on June 9-13, 2003, and the arbitration panel rendered its award on July 11, 2003. The arbitrators' award has been filed of record in this cause by Defendant RLI Insurance Co. in support of its motion to confirm the arbitration award. For the reasons set out in the Memorandum Opinion entered today in this matter, the Court has granted Defendant RLI Insurance Co.'s motion to confirm the arbitrators' award pursuant to 9 U.S.C. §9.

Accordingly, it is

ORDERED and **ADJUDGED**

That the award of the arbitrators in this matter is hereby **CONFIRMED**;

That Defendant RLI Insurance Co., shall have of and recover from Veranda Beach, L.L.C., the principal sum of $237,154.71, plus all taxable costs of Court, as set forth in the award of the arbitrators dated July 11, 2003, and incorporated into this judgment by reference; and

That interest at the rate of 1.7% per annum shall accrue on the principal sum from the date of entry of this order until the judgment is paid.

SO ORDERED this 29th day of April, 2004.

s/ L. T. Senter, Jr.
L. T. Senter, Jr.
Senior Judge

APPENDIX B — ARBITRATORS' DECISION

AMERICAN ARBITRATION ASSOCIATION CONSTRUCTION INDUSTRY ARBITRATION TRIBUNAL

In the Matter of the Arbitration between

Re: 69 Y 110 00348 02
Veranda Beach, LLC
vs.
RLI Insurance Company

ADMINISTRATOR: Heather Presley
ARBITRATORS: Craig L. Kaster, Patrick H. Scanlon, and John Hill Allgood, III

WE, THE UNDERSIGNED ARBITRATORS, having been designated in accordance with the arbitration agreement entered into by the parties, and having been duly sworn and having duly heard the proofs and allegations of the parties hereby, AWARD, as follows:

This matter came up at the hearing in Biloxi, MS starting June 9th and was concluded June 13th. The hearing was closed on June 13th and the arbitrators met thereafter for deliberation.

Based on the evidence presented through testimony and exhibits, this project was doomed from the outset. The owner and contractor chose to start work prior to obtaining a final set of plans and with very limited specifications. To make matters worse, the plans that were used were not complete.

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Furthermore, the architect did not provide complete administrative services and the contractors work force as well as supervision was poor for the first six months. Neither party should have signed the contract based on the woefully inadequate specifications and the incomplete plans. They undertook substantial risk by signing a contract without proper plans and specifications which led to a great deal of confusion and ultimately substantial disputes.

The owner and contractor often made very important decisions without adequately consulting the permitted drawings and without input from the architect. This led to rework and ultimately numerous code violations.

Both parties have made substantial delay claims. However, they jointly share in the concurrent delays resulting in the failure to complete this project in a timely fashion. The defendants exhibited bate stamp 100271 is an October 12, 2001 letter from Mr. Gentle to Mr. Hopkins regarding a stop work notice from the city of Biloxi. It sets forth the code violations which resulted in a project being stopped by the city. On October 19, 2001, the city issued its memorandum of code violations.

Based on the evidence, a couple of out of state buyers went to the permit office and in reviewing the project plans on file, found code violations which were reported to the city. This resulted in the city's code enforcement manager shutting the project down. If two third parties could review and find code violations, then certainly the owner, through its architect and the contractor as well as the surety could and should have found these problems long before October of 2001. As

a result of the joint failure of the owner/architect and contractor/surety to properly monitor the work and be sure it complied with the code requirements, the parties are jointly responsible for the concurrent delays and neither party is entitled to delayed damages.

The owner argues that the project is still not substantially complete. However, the city issued a Certificate of Occupancy on December 17, 2000 (Exhibit G1987). This allowed units to be sold. The owner did start closing on sales and the architect did issue a punch list (Exhibit P257). Based on the evidence the arbitrators find the project was substantially complete as of December 17, 2001, even though the parties did not sign a Certificate of Substantial Completion.

A large amount of time was taken up in the arbitration with regard to the allegations of fraud and claim for punitive damages brought by Veranda Beach, LLC, Claimant. Fraud must be proven by clear and convincing evidence. In this hearing, evidence was introduced on the issue of fraud. There was evidence relating to changes to the "outlined specifications" Ms. Sherry gave expert testimony on this issue. However, her testimony was of no assistance in determining who, when or why changes were made to the "outlined specifications". Counsel for Veranda Beach, LLC questioned nearly every witness on this issue and it is still unclear as to who, when or why these "outlined specifications" were altered.

Furthermore, there has been no evidence as to the use of the altered "outlined specifications". During the hearing, some

witnesses for both parties gave testimony that was inconsistent with written documents or other testimony. This may have an impact as to their credibility, but does not meet the legal requirements amounting to fraud.

There were change orders submitted to the owner related to disputed issues, and in fact, RLI Insurance Company filed a lien including money for disputed change orders. Mr. Williams testified that the lien was filed to protect RLI's rights because of possible foreclosure on the property. Neither the submission of disputed change orders nor the filing of the lien was fraudulent.

Much of the case presented by Veranda Beach has been an attempt to prove fraud on the part of RLI and persons related to the Surety. The arbitrators listened carefully to the testimony and reviewed the exhibits on this issue. It is the unanimous finding the panel there has been absolutely no evidence produced amounting to fraudulent conduct on the part of RLI Insurance Company, Robert Gentle, Russell Gill, Ms. David, Christopher Gilley, or Edgar Williams. Accordingly, all claims for punitive damages by Veranda Beach, LLC are dismissed with prejudice. Since a large portion of the time in arbitration was spent on this issue, Veranda Beach is ordered to pay one-half of the arbitrator expenses, fees and costs associated with this proceeding since it was not able to prove these allegations.

There was a great deal of conflict in testimony as to what plans and specifications were included as part of the contract documents. After much deliberation, it is the finding of the arbitration panel that the contract included the March 2,

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2000 plans set forth in Defendant's Exhibit 3B Gilley Volume II, and the type written specifications with the handwritten notes (Plaintiff Exhibit A-3).

The following is awarded to Veranda Beach for the cost to complete, incomplete or defective work and work omitted:

Credit 6 inch sewer	$	2,100.00
Backflow preventor	$	2,800.00
Curb and gutters	$	480.00
Credit for Brick Ledge at Handicap Ramp	$	140.00
Credit Walks	$	4,190.00
Credit Front Balconies/ Store Rooms	$	14,634.00
Credit Interior Trim Panels e/c Doors	$	1,080.00
Credit Trim at Door Frames	$	1,500.00
Credit Window Seals	$	500.00
Fix and Adjust Windows	$	50.00
Add Parking Bumpers	$	500.00
Correct 8 Pane Window	$	500.00
Clear A/C Drain	$	150.00
Brick at Back Stairs	$	150.00
Rework Soffit at Rear Balconies	$	1,500.00
Coping at Pool	$	1,200.00
Replace Elevator Room Roof	$	960.00
Replace Pool house Roof	$	384.00
Gutters/DP Rear Building	$	636.00
Tub Surrounds	$	2,800.00

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Replace Dryer Vents	$	240.00
Replace Washer Drains	$	240.00
Credit Wire Mold at FA Wire	$	720.00
Microwave Outlets	$	1,500.00
Mold Remediation for one unit	$	3,400.00
Total	$	42,354.00

All other claims of Veranda Beach, LLC are denied.

RLI has made claims for change order work. It is the finding of the arbitration panel that change orders 1-4 were agreed to by the parties through the Memorandum of Understanding. However, while the change order procedure set forth in the contract documents were not followed, there was change order work performed by the contractor with the knowledge and consent of Veranda Beach and therefore RLI is entitled to recover with regard to those change order, but since the change order procedure was not followed, the recovery is limited to a quantum meruit basis. The following is awarded to RLI, in addition to change orders 1-4:

No. 5: Modify Roof Trusses for New Roof Design	$	5,446.00
No. 7: Add Knee Walling Behind Cabinets	$	3,255.00
No. 8: Ductwork Removed and Relocated	$	2,500.00
No. 11: Additional Fire Caulk	$	.465.00

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No. 14: 5/8" Drywall at Separation Walls	$	3,487.50
No. 16: Pool Elevation Change	$	6,855.28
No. 17: Add Sidewalk to East Wall	$	1,046.25
No. 24: Upgrade Counter-tops in Bathroom	$	2,053.00
No. 26: Add Bartops	$	826.50
No. 27: AC Pads	$	1,924.00
No. 28: Construction Loan Payment	$	6,500.00
No. 30: Replace Handicap Ramp	$	4,966.00
No. 31: Sprinkler Pipe Enclosure	$	6,159.00
No. 32: Iron Gate, Metal Fencing (Front)	$	16,305.00
No. 33: Further Upgrades Per Sales Agreement	$	2,381.00
No. 34: Mechanical Room Modifications	$	7,595.51
No. 36: Add Vanity Lights	$	872.29
No. 37: Add Gates at Rear Balconies	$	1,400.00
No. 41: Pre-wire Security/ Alarm Systems	$	2,471.38
Total	$	76,508.71

All other claims by RLI Insurance Company are denied.

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The following is a summary of the award:

Unpaid Contract Balance	$	186,190.00
Change Orders 1-4	$	16,810.00
Additional Change Orders on Quantum Meruit	$	76,508.71
Subtotal	$	279,508.71
Less Credits to Veranda Beach	$	42,354.00
Balance to be paid by Veranda Beach, LLC to RLI Insurance Company	$	237,154.71

It is the finding of the arbitration panel that Veranda Beach, LLC is to pay RLI Insurance Company $237,154.71. The funds on deposit in escrow are to be released to RLI Insurance Company as part of this payment. Once Veranda Beach, LLC has paid the full $237,154.71, the lien filed by RLI Insurance Company is to be canceled.

Since a portion of the contract claims for both parties was granted a portion denied, the parties are equally obligated to pay the remaining arbitration cost, fees and expenses.

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Accordingly, Veranda Beach, LLC is obligated to pay 75% of the arbitration fees, costs and expenses, and RLI Insurance Company is obligated to pay the remaining 25% of the arbitration fees, costs and expenses. Any amounts not paid to RLI Insurance Company within 30 days will bear legal interest in accordance with Mississippi law.

The administrative fees and expenses of the American Arbitration Association ("the Association") totaling $16,500.00 and the compensation and expenses of the arbitrators totaling $34,800.05 shall be both 75% by Veranda Beach, LLC and the 25% by RLI Insurance Company. Therefore, Veranda Beach, LLC shall pay to RLI Insurance Company the sum of $10,466.89 representing its share of deposits previously advanced the Association.

The above sums are to be paid on or before 30 days from the date of this Award.

This Award is in full settlement of all claims and counterclaims submitted to this Association. All claims not expressly granted herein are, hereby denied.

This Award may be executed in any number of counterparts, each of which shall be deemed an original, and all of which shall constitute together one and the same instrument.

SIGNED: Pat H. Scanlon DATED: 7/11/03
Patrick H. Scanlon, Arbitrator

Accordingly, Veranda Beach, LLC is obligated to pay 75% of the arbitration fees, costs and expenses, and RLI Insurance Company is obligated to pay the remaining 25% of the arbitration fees, costs and expenses. Any amounts not paid to RLI Insurance Company within 30 days will bear legal interest in accordance with Mississippi law.

The administrative fees and expenses of the American Arbitration Association ("the Association") totaling $16,500.00 and the compensation and expenses of the arbitrators totaling $34,800.05 shall be both 75% by Veranda Beach, LLC and the 25% by RLI Insurance Company. Therefore, Veranda Beach, LLC shall pay to RLI Insurance Company the sum of $10,466.89 representing its share of deposits previously advanced the Association.

The above sums are to be paid on or before 30 days from the date of this Award.

This Award is in full settlement of all claims and counterclaims submitted to this Association. All claims not expressly granted herein are, hereby denied.

This Award may be executed in any number of counterparts, each of which shall be deemed an original, and all of which shall constitute together one and the same instrument.

SIGNED: John Hill Allgood, III DATED: 7/11/03
John Hill Allgood, III, Arbitrator

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Accordingly, Veranda Beach, LLC is obligated to pay 75% of the arbitration fees, costs and expenses, and RLI Insurance Company is obligated to pay the remaining 25% of the arbitration fees, costs and expenses. Any amounts not paid to RLI Insurance Company within 30 days will bear legal interest in accordance with Mississippi law.

The administrative fees and expenses of the American Arbitration Association ("the Association") totaling $16,500.00 and the compensation and expenses of the arbitrators totaling $34,800.05 shall be both 75% by Veranda Beach, LLC and the 25% by RLI Insurance Company. Therefore, Veranda Beach, LLC shall pay to RLI Insurance Company the sum of $10,466.89 representing its share of deposits previously advanced the Association.

The above sums are to be paid on or before 30 days from the date of this Award.

This Award is in full settlement of all claims and counterclaims submitted to this Association. All claims not expressly granted herein are, hereby denied.

This Award may be executed in any number of counterparts, each of which shall be deemed an original, and all of which shall constitute together one and the same instrument.

SIGNED: Craig L. Kaster DATED: 7/11/03
Craig L. Kaster, Arbitrator